Income Measurement

1. Matching Principle (Expense Recognition)

Definition:

- Expenses are recognized in the **same accounting period as the revenues they help generate**.
- Purpose: Accurately measure **profit** for a period:

Profit=Revenue−Expenses related to that revenue

Key Concept:

- Direct costs (product-related) → **matched to revenue**
- Period costs (not directly tied to revenue) → **expensed when incurred**

A. Costs Matched to Revenue (Product Costs / Direct Costs)

- Recognized **in the period revenue is earned**, not necessarily when cash is paid.
- **Examples:**

Cost Type	When Incurred	When Recognized (Matched to Revenue)
Manufacturing labor	During production	When product is sold (COGS)
Raw materials	Purchased earlier	When used to produce revenue-generating goods
Sales commissions	Paid after sale	Recognized in the period of sale

Notes:

- These costs can sit in **inventory (WIP / Finished Goods)** until the product is sold.
- Aligns expense recognition with revenue → **true profitability for the period**.

B. Expenses Recognized When Incurred (Period Costs / Indirect Costs)

- Costs **not directly tied to revenue** are expensed immediately.
- **Examples:**

Cost Type	Treatment
Administrative salaries	Expense immediately
Rent for office	Expense immediately
Utilities	Expense immediately

Notes:

- Period costs do **not sit in inventory**.
- They reflect the cost of operating the business during the period, irrespective of revenue.

C. Quick Memory Rule

- **Direct / product costs (COGS)** → "**Match to revenue**"
- **Indirect / period costs** → "**Expense when incurred**"

Example – Combined Illustration

Item	When Incurred	Revenue Earned	When Expense Recorded	Type
Raw materials	Sept 20	Oct 10 (sale)	Oct 10	Direct / matched to revenue
Labor	Oct 5–7	Oct 10 (sale)	Oct 10	Direct / matched to revenue
Admin salaries	Oct 1	Not tied to sales	Oct 1	Period / expensed when incurred

 Key Point: Only expenses **directly tied to generating revenue** are "matched" to that revenue. Others are **expensed immediately**.

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2. Revenues vs Gains

Feature	Revenues	Gains
Source	Core operations	Non-core transactions (e.g., sale of fixed asset > book value)
Frequency	Recurring	Usually non-recurring

Feature	Revenues	Gains
Reporting	Income statement	Income statement (outside operating income)

3. Expenses vs Losses

Feature	Expenses	Losses
Source	Primary operations (COGS, admin, depreciation)	Non-core/unusual events (e.g., asset sold below book, involuntary disposal)
Timing	Recognized when incurred / systematically allocated	Recognized when event occurs or loss is known
Effect	Reduces equity	Reduces equity

4. Involuntary Disposal of Assets – CMA US Context

□ Definition

An involuntary disposal occurs when a company loses an asset due to events beyond its control, such as:

- Theft
- Physical damage or destruction (e.g., fire, flood)
- Condemnation (declared unfit for use)
- Government seizure (e.g., eminent domain)

These are **not voluntary sales** — the asset is taken or destroyed due to external forces.

□ Accounting Treatment

Even though the asset wasn't sold in the traditional sense, **any proceeds received** (like insurance payouts or government settlements) are treated **as if the asset was sold**.

Why? To reflect the economic reality — the company is compensated for the asset, so the accounting treatment mirrors a sale transaction.

Steps:

- Remove the asset from the books.
- Record the proceeds received.
- Recognize any gain or loss:
    - **Gain**: If proceeds > book value
    - **Loss**: If proceeds < book value

🔹 Example

Let’s say a machine with a book value of $50,000 is destroyed in a fire. The company receives $40,000 from insurance.

- Book value: $50,000
- Proceeds: $40,000
- **Loss**: $10,000 → recorded in income from continuing operations (but not operating income)

🔹 Exam Tip (from CMA content)

This type of disposal is **non-core** and **unusual**, so it’s classified as a **loss**, not an expense. It’s reported in the income statement under **income from continuing operations**, but **outside operating income**.

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5. Held-for-Sale Assets

Criteria:

1. Management **commits to a sale plan** (recommendation is insufficient).
2. Asset is **available for immediate sale**.
3. **Actively marketed** at a reasonable price.
4. Sale is **probable within 1 year**.
5. Actions make **plan unlikely to change**.

Measurement:

- **Lower of carrying amount or fair value – costs to sell**.
- **Example:**
    - Old computer NBV = $27,000, trade-in value = $10,000 → Reported at $10,000, recognize loss = $17,000.

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6. Reporting Gains and Losses

- Gains/losses from **non-core transactions** → Income from continuing operations, **not operating income**.
- **Example:** Sale of machinery at $15,000 when NBV = $10,000 → $5,000 gain reported in continuing operations.

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7. Net Income vs Comprehensive Income

Feature	Net Income	Comprehensive Income
Includes	Revenues + Gains – Expenses – Losses	Net Income + Other Comprehensive Income (OCI)
OCI Examples	Unrealized gains/losses on AFS securities, pension adjustments, foreign currency translation	Recorded directly in **equity (AOCI)**, not on income statement
Key Difference	Reflects performance of operations	Broader measure of overall financial performance

Formula:

$$\text{Comprehensive Income} = \text{Net Income} + \Delta\text{AOCI}$$

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8. Exam Tips – CMA US

1. Apply **matching principle** carefully – only direct costs are matched to revenue.
2. Distinguish:
    - **Revenue vs Gains** (core vs non-core)
    - **Expenses vs Losses** (core vs non-core/unusual)
3. Held-for-sale assets → **lower of carrying value or FV – costs to sell**.
4. Gains/losses → **continuing operations, not operating income**.
5. Comprehensive income = Net Income + **OCI** → broader view of performance.